

**State of Alaska**  
**ALASKA RETIREMENT MANAGEMENT BOARD**  
**MEETING**

**Location**  
Centennial Hall  
Egan Room  
Juneau, Alaska

**MINUTES OF**  
**February 18, 2016**

**Thursday, February 18, 2016**

**CALL TO ORDER**

CHAIR GAIL SCHUBERT called the meeting of the Alaska Retirement Management Board (ARMB) to order at 9:00 a.m.

**ROLL CALL**

Nine ARMB trustees were present at roll call to form a quorum.

**Board Members Present**

Gail Schubert, *Chair*  
Sam Trivette, *Vice-Chair*  
Gayle Harbo, *Secretary*  
Kristin Erchinger  
Commissioner Sheldon Fisher  
Commissioner Randall Hoffbeck  
Martin Pihl  
Tom Brice  
Sandi Ryan

**Board Members Absent**

None

**Investment Advisory Council Members Present**

Dr. Jerrold Mitchell  
Robert Shaw

**Investment Advisory Council Members Absent**

Dr. William Jennings

**Department of Revenue Staff Present**

Gary M. Bader, Chief Investment Officer  
Scott Jones, State Comptroller  
Bob Mitchell, State Investment Officer  
Zachary Hanna, State Investment Officer  
Shane Carson, State Investment Officer  
Joy Wilkerson, State Investment Officer  
Emily Howard, State Investment Officer  
Victor Djajalie, State Investment Officer  
Casey Colton, State Investment Officer  
Pamela Leary, Director, Treasury Division  
Judy Hall, Board Liaison

**Department of Administration Staff Present**

Jim Puckett, Chief Operating Officer, Division of Retirement & Benefits  
Kevin Worley, Chief Financial Officer, Division of Retirement & Benefits  
John Boucher, Senior Economist, OMB

**Consultants, Invited Participants, and Others Present**

Stuart Goering, Department of Law, Assistant Attorney General  
Todd Rittenhouse, Mondrian Investment Partners Ltd.  
Matt Day, Mondrian Investment Partners Ltd.  
Douglas McNeely, BlackRock  
Laura Champion, BlackRock  
Corin Frost, BlackRock  
Kathryn Donovan, BlackRock  
Paul Erlendson, Callan Associates, Inc.  
Steve Center, Callan Associates, Inc.  
John Holmgren, Zebra Capital Management  
Roger Ibbotson, Zebra Capital Management

**PUBLIC MEETING NOTICE**

JUDY HALL confirmed that public meeting notice requirements had been met.

**APPROVAL OF AGENDA**

MRS. HARBO moved to approve the agenda. MS. RYAN seconded the motion.

The agenda was approved.

**PUBLIC/MEMBER PARTICIPATION, COMMUNICATIONS AND APPEARANCES**

None.

## **APPROVAL OF MINUTES: December 3-4, 2015**

MRS. HARBO moved to approve the minutes of the December 3 - 4, 2015 meeting of the ARM Board. MS. RYAN seconded the motion.

The minutes were approved.

### **REPORTS**

#### **1. CHAIR REPORT**

None.

#### **2. COMMITTEE REPORTS**

##### **A. Audit Committee**

MR. PIHL reported that the Audit Committee had a well-attended meeting the day before the Board meeting, with a fairly light agenda. The Department of Administration gave an update on the employer audit program and its replacement, and a summary of the audit activity over the year.

The Audit Committee had a rather long discussion on how GASB 68 has played out, and received a compliance report from Mr. McKnight and Pam Leary from the Department of Revenue.

##### **B. Actuarial Committee**

MS. ERCHINGER reported that the Actuarial Committee met the day before the Board meeting, and representatives from Buck attended, including Larry Langer, a new member who will be leading the Buck team. MS. ERCHINGER commented that she thinks Larry will be a great asset to the ARM Board Actuarial Committee.

MS. ERCHINGER reported that the primary agenda item was an update on the timing for the 6/30/2015 valuation. The Actuarial Committee did not receive the valuation yesterday, as statute requires that the review actuary review the information before it comes to the full Board. MS. ERCHINGER said that she is looking into whether it is possible for the committee to get parts of the draft valuation report earlier instead of waiting for the final report to be fully reviewed by the review actuary, because if the committee doesn't get it until the very end, they don't have enough time to review it before it comes before the full Board. The goal is to vet the 6/30/2015 valuation report at the April meeting, which will give them time to make recommendations before that report comes to the full Board to approve employer contribution rates at the June meeting.

MS. ERCHINGER reported some numbers that Buck gave as a high-level overview of the first draft of this valuation. The results show that the overall funded ratio for PERS for the DB plan rose from 70 percent to 78 percent due to the injection of state funds in FY 2015. The TRS DB plan funded ratio rose from 61 percent to 83 percent. On the DCR plan, the funded ratio for PERS increased

from the 2014 to 2015 valuation from 77 percent to 98.8 percent. For TRS DCR, the increase was from 83.5 percent to 105.3 percent. MS. ERCHINGER said that they were told that these funding ratio increases were a result not only of the state assistance payment in FY 2015, but also retiree medical claims being much less than anticipated.

MS. ERCHINGER explained that the funding ratios of pension and healthcare in those plans are very lopsided. The draft valuation report showed that in the DB plan, in 2015 PERS healthcare is 99 percent funded, and TRS healthcare is 100 percent funded. However, on the pension side, the funding ration for PERS is only 67 percent and for TRS is 77 percent. Therefore, Buck recommends that for the 2015 valuation, 100 percent of state assistance be allocated to pension and zero percent to healthcare. MS. ERCHINGER stated that the Actuarial Committee supports this recommendation.

MS. ERCHINGER moved on behalf of the Actuarial Committee that the ARM Board shift the allocation of state assistance for one year in 2017 with 100 percent allocated to DB pension and zero percent allocated to DB healthcare.

MR. PIHL stated that he erred yesterday in voting with the committee because they didn't have the full report, and he thinks this should be postponed until April or June. MR. PIHL said that the larger issue is regarding all the other allocations between pensions and healthcare, so he is not in favor of voting on this until the Department of Administration and Buck come back with a look at the larger allocation problem. He noted that the allocation that was done last fall of 83 percent to pensions and 17 percent to healthcare resulted in a huge increase in what the state and municipalities had to report as their employer share. Therefore, MR. PIHL said he would abstain from the vote.

COMMISSIONER FISHER commented that there may still be some question as to whether the allocation was appropriate, but he thinks it is not fairly characterized as an inappropriate allocation. He noted that the committee did take action and wrote a report in yesterday's meeting.

A roll call vote was taken on the motion by MS. ERCHINGER. All voted in favor except MR. PIHL. The motion passed.

MS. ERCHINGER stated that the Actuarial Committee had also addressed a procedural issue about what actions taken in the committee require ratification by the full Board. They decided to present the reports that they have operated on in their first two meetings to the full Board.

The Actuarial Committee has had three full meetings. At the first two, on August 14, September 23, the committee solely focused on the audit findings that had come before the Board as a result of GRS's review. The committee, GRS, and Buck together went through the audit findings one by one and decided on ways to resolve each finding. MS. ERCHINGER noted that there are just a few items remaining to resolve. She commented that because the committee gave direction to the actuary in some instances, those types of decisions are things that the full Board should be ratifying.

Therefore, MS. ERCHINGER asked the full Board to accept the report from the Actuarial Committee and their recommendations for further action as decided in the committee meetings with

Buck and the actuary, so that the requests for certain information will be represented in the upcoming valuation.

MS. ERCHINGER moved to ask the full Board to approve the report from the Actuarial Committee, as well as the recommendations included in the action column to the right on the schedules, which were included in meeting materials. MRS. HARBO seconded the motion.

A roll call vote was taken, and the motion passed unanimously.

MRS. HARBO commented on how productive it was to have the two actuaries and the committee all sit down together on August 14.

MS. ERCHINGER added that the committee had agreed that they want to make sure that when direction is given to Buck or the review actuary to do work on behalf of the committee, they follow the same procedures as the Board follows, which is to request the information in writing and seek the Chair's approval on whether or not to forward it as a formal request. Therefore, the committee has two items that they will be forwarding for approval, one of which is a review of a schedule produced by MR. PIHL about the allocation issue.

### **C. DC Plan Committee**

MR. TRIVETTE reported that the DC Plan Committee had an ambitious schedule the day before this meeting, with three major topics that they spent considerable time on.

The committee received an update from DRB on the survey that Empower (which used to be Great West) is conducting of people who took disbursements from their DC accounts. They are modifying the survey and trying to figure out how to get more people to take it. Empower is also doing new initiatives to educate members and will be doing training throughout the upcoming year, as well as making information available online so people in remote sites can access it.

MR. TRIVETTE reported that the committee had hoped to get some information on Health Reimbursement Accounts, as they had some concerns that the balances may not be very big, similar to what they learned of individual DCR account balances. The data was not available, but the committee was told that it will be available for the next Board meeting. MR. TRIVETTE stated that DRB is also making other changes currently, such as making deferred compensation available to all public employees, not just State of Alaska workers.

MS. HARBO asked whether it is known how many people in the HRA program are over 65 or close to 65, and whether those people are able to view their accounts. COMMISSIONER FISHER responded that the data is available, but he hasn't examined it; MR. TRIVETTE said that he doesn't think that individual participants are able to access the information themselves now, and that is an issue they have been pursuing.

The third issue that the DC Plan Committee discussed is the range of options available to participants in the DC plan. The committee discussed at the September meeting possibly having a

firm examine whether the current system encompasses all of the best practices or if changes should be made. MR. BADER talked to Callan, which has a DCR plan group with expertise in this area, and they are interested in doing a review for Alaska. MR. TRIVETTE reported that the committee passed a motion supporting the state spending the money to get this review done. The Department of Revenue confirmed that money is available in the budget to do it, and the action will be on the agenda later in this meeting.

MR. TRIVETTE stated that the DC Plan Committee decided that they needed a regular schedule for committee meetings, and have decided to meet in February and in September each year.

#### **D. Legislative Committee**

CHAIR SCHUBERT said that the Legislative Committee did not meet, and this should not be on the agenda.

### **3. DIVISION OF RETIREMENT & BENEFITS REPORT**

#### **A. Membership Statistics/Buck Invoices/HRA Rates**

MR. WORLEY reported the membership statistics for December 31, 2015. Compared to the prior year, PERS DB membership has declined by 1,700 and PERS DC has increased by 1,100. TRS DB has decreased by 460 and TRS DC has increased by 420. There was no material change in terminated membership. Retirees and beneficiaries have increased by about 1,250 in PERS and 350 in TRS, for a total increase of about 1,600. MR. WORLEY reported that in calendar year 2015, the Division processed over 2,200 retirement applications, handled almost 94,000 phone calls, and responded to almost 61,000 e-mails.

MR. WORLEY stated that the Buck Consultants billings are pretty standard, and quarterly reports have been provided. At the Board's request, a prior-year summary for the same quarter was included.

MR. WORLEY said that the new annual amount for HRAs for FY 17 has been computed to \$2,049.36, which they show broken down into quarterly, monthly, biweekly, and so on for different pay period structures. He noted that a member who had worked since the inception of the program until now would have at least \$16,000 in their account without interest. MR. WORLEY added that the Division is working on the balances within the account, and they will be in MyRnB access, so members will be able to access their balances through the portal.

#### **B. Legislative Update**

MR. BOUCHER reviewed the pending bills that are of interest to the ARM Board.

- HB 47 would modify the 2008 salary floor for a specific set of communities that have sustained a significant population drop between 2000 and 2010, and would modify the interest rate that is charged on late contributions for those entities.

- HB 66 would extend retiree health insurance to dependents of deceased public employees.
- HB 90 is the peace officer and firefighter retirement bill, which would cover certain employees with a combination Defined Benefit, Defined Contribution plan.
- HB 211 would structure a retirement incentive program for public employees in the Teachers' Retirement System. They did an initial analysis, but heard that the bill is going to be amended.
- SB 79 has a companion bill, HB 172, which would allow the reemployment of members who retire from the TRS DB plan.
- SB 88/HB 280 would provide for a new defined benefit tier for employees who were first hired after July 1, 2013. They would be defaulted into either a new defined benefit tier, TRS Tier IV or Tier V, but they would also be able to elect between the DC and the DB plans.
- HB 299 provides some clarifying language excluding certain contract instructors from the PERS and TRS system.

#### **4. DEPARTMENT OF REVENUE UPDATE**

COMMISSIONER HOFFBECK noted that one of the provisions of the Governor's total fiscal plan was to potentially use pension obligation bonds as a way to flatten the obligation to the pension system by changing it to a debt obligation. COMMISSIONER HOFFBECK said that in a hearing before House Finance, it was clear that there is a fear of debt, and they are probably going to shelve the idea for this year. However, they will continue to try to promote the benefits of this approach.

#### **TREASURY DIVISION REPORT**

DIRECTOR PAM LEARY reported that they presented the treasury and the ARM Board budget to the House subcommittee. It was substantially the same budget as they presented in the September meeting; they have answered questions, and not heard many objections, but the budget has not been finalized yet.

#### **5. CHIEF INVESTMENT OFFICER REPORT**

Chief Investment Officer GARY BADER reported a rebalancing between the PERS and TRS and the various funds associated with them. He reported on various transactions, and reviewed the watch list.

MR. BADER requested a motion to modify the watch list.

MRS. HARBO moved to have the Board remove Coventry, Everest, Lehman, and MacKay Shields from the watch list. MR. TRIVETTE seconded the motion. The motion passed by unanimous consent.

MR. BADER reviewed a report in the packet about net of fee returns. Callan worked with them on a presentation that he think fairly represents the Board's investment returns and a way to compare them with the fees that are incurred in earning those returns. They plan to have Callan present this report each year in September.

MR. BADER reviewed some staff changes at various investment firms, then responded to a question from a previous meeting. COMMISSIONER FISHER had asked what the correlations were between fixed income and Schroder's inflation-linked security strategy, and between equities and that strategy. MR. BADER stated that the correlation with the S & P 500 is .36, and with fixed income, .14, very low, which fits what they expected.

MR. BADER noted that there is an action item later on the agenda involving the approval of a fixed income policy statement for high yield. It did not include the usual red lines marking changes, but MR. BADER offered to show Board members a copy with the changes marked before the vote.

## **6. FUND FINANCIAL REPORT**

State Comptroller SCOTT JONES reviewed the financial statements for the six months ending December 31, 2015. The ending invested assets were \$28 billion, with a change in invested assets of negative 3.5 percent, 2.71 percent of which was related to income. This total comprises the PERS system with \$15.8 billion, the TRS system with \$7.8 billion, the JRS with \$169 million, the military with \$35.6 million, SBS with \$3.3 billion, and Deferred Compensation with \$792 million. MR. JONES stated that January wasn't a great month, as the assets among the various plans decreased by a total of about \$1 billion to \$27 billion. Of that, \$914 million was a loss in the markets, and \$102.8 million was the month's net withdrawal from the plan. The net inflow of cash for January was \$2.5 million.

MR. WORLEY directed board members to the supplement at the end of his report. He pointed out the differences between benefits being paid out monthly and contributions coming in for each plan. VICE-CHAIR TRIVETTE commented that the advantage of these systems is that 65-70 percent of the money spent on benefits is paid by neither the employer nor the employee, but comes from the return on equity, which is the Board's responsibility to earn.

## **7. FUTURES**

MR. BADER introduced this as the first of three interrelated presentations during this Board meeting, on futures, swaps, and alpha. He began by explaining the history of these trading vehicles, why they came to be and how they have evolved. MR. BADER said that futures contracts enable one to acquire a great amount of market exposure with only a small amount of money up front. MR. BADER gave several examples of how the futures exchange works and explained that leverage is high in these transactions. He noted that the ARM Board has been using futures since

2006 in a cash equitization program, and through 2015 had netted roughly \$15 million. State Street Global Advisors has been coordinating the program, but it costs about \$23,000 a year; MR. BADER said that staff could do it internally and save a lot of money, or they may be able to negotiate a better fee structure with State Street if activity is increased substantially. MR. BADER noted that an action memo later in the meeting would request to bring the cash equitization program in-house and request approval to go long and short on futures.

CHAIR SCHUBERT recessed the meeting from 10:31 a.m. to 10:47 a.m.

## **8. MONDRIAN INVESTMENT PARTNERS LTD.**

TODD RITTENHOUSE and MATT DAY discussed the organization and philosophy of Mondrian Investment Partners, then reviewed the performance, portfolio positioning, and outlook for the strategy of their investments. MR. RITTENHOUSE explained that Mondrian is independent and employee-owned, and they manage \$57 billion, primarily for institutional investors. The presentation included charts showing Mondrian's client types, asset classes, and products, including the international small cap portfolio that they manage for ARMB.

MR. DAY explained the philosophy and process that the global fixed income team uses as background information for the discussion of performance and positioning. Since its inception in 1997, the ARMB portfolio has had strong long-term results, outperforming by .6 percent in year 2015 despite a lot of volatility in fixed income securities. MR. DAY reviewed the positioning as shown in the written report and explained Mondrian's strategy of investing in foreign currencies and using their proprietary inflation forecasts for other countries. MR. ERLENDSON asked how accurate their forecasts have been historically, and MR. DAY replied that in back testing, they have found their forecasts not as good as perfect foresight but better than the consensus forecasts.

MR. DAY noted that this fund is split 70/30 between international fixed income and emerging markets, and the nominal yield has been 3.9 percent. Board members asked a few technical questions, and CHAIR SCHUBERT asked about the performance net of fees and expenses, which was printed too small in the appendix for her to read. MR. DAY replied that the current fees are 36 basis points, so the fund is handily outperforming the net of fees.

## **9. SWAPS**

MR. BADER stated that swaps were approved some time ago, but since it has been so long, he wanted to review what a swap is and explain why they are asking for authority to engage in swaps anew. MR. BADER said that he would show how swaps could be used to facilitate a return enhancement strategy that is proposed later in the agenda called portable alpha.

MR. BADER defined a swap as an agreement between parties to exchange returns of different asset classes, and gave an example of how it might work. MR. BADER explained that there is infinite leverage in this type of deal, and people can agree to swap returns without putting up any money. Unlike in futures exchanges, there is no clearinghouse associated with swaps; the agreements are between the parties involved, and they have to reset periodically. A dealer can be involved, and

there are several standard types of contracts in frequent usage for swap trades.

MR. TRIVETTE asked how the department is doing with staffing, and if this would take a lot of staff time; MR. BADER replied that for this transaction, staffing is not a concern, but as they attempt to engage in more equity transactions, additional staff would be important.

## **10. BLACKROCK – INDEX FUNDS**

DOUGLAS MCNEELY, the managing director of BlackRock, runs their institutional focus group. LAURA CHAMPION, who works with larger investors, CORIN FROST, the global head of their index products strategy group, and KATHRYN DONOVAN, a product strategist, also joined the meeting. The team from BlackRock presented an overview of four strategies that they currently manage, with total assets of about \$845 million for Alaska.

MS. DONOVAN discussed the global fixed income strategy, which is split almost evenly between active and passive. She reviewed team members and BlackRock's philosophy and process of investing. MS. DONOVAN also discussed the intermediate government bond fund and the government/credit fund.

MR. FROST reviewed the equity index portfolio, and discussed new strategies and trends in index equities. He explained that because it requires such scale, there are only a two or three major index managers globally, and BlackRock is the largest. A team of about 60 based in San Francisco manage the fund. MR. FROST reviewed the team structure, philosophy and process of BlackRock's equity index fund. He stated that the fund outperforms long-term by about 20 basis points per annum, which can be expected year in and year out because of conservative assumptions on dividend withholding taxes.

MR. MCNEELY thanked the ARM Board for their confidence in BlackRock and for having them at the meeting.

CHAIR SCHUBERT recessed the meeting from 11:58 a.m. to 1:30 p.m.

## **11. CAPITAL MARKETS ASSUMPTIONS**

PAUL ERLENDSON and STEVE CENTER from Callan Associates presented information on why they do capital markets assumptions, how they are used, and some background on what informed their views in the 10-year forward-looking projections that cover the period 2016 through 2025.

MR. ERLENDSON explained that the purpose of capital markets assumptions is to come up with a rational basis for deploying assets. The main questions to be answered are what liabilities need to be funded, and what is the time horizon? Decisions about how to invest and how much risk to take depend on those issues. MR. ERLENDSON explained that when Callan does their assumptions, they are looking at a five-to-ten-year period, because market cycles take a while to play out the difference between value and growth, currency movements, and interest rate trends. A five-to-ten-year horizon generally captures full cycles, whether peak-to-peak or trough-to-trough.

MR. ERLENDSON explained some of the considerations that go into establishing their expectations. He said that they look at the different attributes of various asset classes, the expected volatility and expected return, and come up with a midpoint around which they try to capture how much uncertainty there is. Then they create a diversified portfolio. MR. ERLENDSON noted that trustees must question whether active management with its higher fees is warranted. A better outcome is expected, or at least a lower risk, than if capital were passively invested in the index fund. Callan will work with investment staff to determine where they can add value.

MR. ERLENDSON explained that they do this exercise annually, and there is rarely much change in their outlook from year to year because things get smoothed over a ten-year period. He discussed some of the economic issues that they take into consideration, and said that they view most asset classes as fairly valued. He mentioned the effect of lower oil prices, and the question of when interest rates will go up and how quickly.

MR. ERLENDSON reviewed some history to reiterate his point that time horizon matters, and emphasized that investors should carefully consider their choices in a strategic mix and then stick with it. MR. ERLENDSON pointed out that two asset classes that ARMB has significant exposure to, real estate and private equity, are the two highest-returning asset classes over the longer period, and lately other investors are getting into them, while ARMB has been benefiting all along.

MR. ERLENDSON discussed Callan's observations on gross domestic product growth, job market growth, slowing growth in China, and inflation. He noted that in the U.S., student debt now exceeds consumer debt, median household income is relatively flat, and many people are not saving for retirement.

MR. CENTER discussed the individual sectors – fixed income, domestic equity, international equity, and emerging markets – and how data from those markets informed Callan's capital market projections. Interest rates are low in developed markets all over the world, and Europe and Japan have entered into a period of the quantitative easing that the U.S is currently coming out of. MR. CENTER explained that if interest rates rise, assets can be reinvested at the higher rates, and he would not advise moving away from fixed income, because it is an important, low-risk part of Alaska's investment plan.

MR. CENTER reviewed the U.S. equity market, which is examined in several different ways. As to whether it is underpriced, overpriced, or fairly priced, based on price-to-earnings multiples, MR. CENTER said it may be slightly overvalued but generally looks well-valued. Earnings growth has slowed and will probably remain stagnant, but the profit growth for the U.S. market is expected to continue to improve. MR. CENTER said that dividend yields have grown rapidly since 2012, but growth is expected to return to a more moderate pace. In the non-U.S. equity market, there is a lot of uncertainty, with more volatility in P/E ratios than in the U.S., but some recovery in dividend growth; price valuations are near long-term averages in non-U.S. equities.

MR. CENTER reviewed emerging markets, commenting that valuations are very attractive right now, but growth in earnings and dividend yields have been depressed. Price-to-earnings ratios in

emerging markets dipped during 2015, and there is a lot of room for growth.

MR. ERLENDSON reviewed the capital market expectations for the major asset classes, including the compounding rate they expect to take place over 10 years and the projected risk around that return. He pointed out that in many cases the return expectations have been decreased, but so has the risk; compared to the past couple of years when Callan has been increasing the volatility, now they think these asset classes are starting to stabilize, but at lower expected returns.

MR. ERLENDSON talked about the mathematical components of Callan's model, and acknowledged that it involves a lot of informed judgment. Callan is going to work with the staff and the IAC to modify some of the assumptions to account for ways that Alaska differs from the broad market. MR. ERLENDSON stated that they would report on the modifications they are making at the next meeting.

MR. PIHL asked whether an 8 percent return is unachievable; MR. ERLENDSON replied that there are ways of eking out incremental value, but the higher the return target, the lower the probability of achieving it. He estimated the probability of being able to raise a 7 percent expected return to 8 percent at about 40 percent. MR. ERLENDSON added that the time horizon on the liabilities of the DB pension fund, though halfway through, is still long, but acknowledged that a case could be made for de-risking and lowering return expectations as the horizon shortens.

## **12. PORTABLE ALPHA**

MR. BADER defined portable alpha as a risk-adjusted excess return of the market. If an investment has the same market risk as the index referred to, but achieves a higher return, that is called excess alpha. In order to transfer or port that alpha to a different asset class, futures or swaps can be used. MR. BADER said that portable alpha is an investment strategy targeting a specific market exposure with a source of alpha that is independent of the market. A portable alpha program requires either futures or swaps, and a consistent and reliable source of alpha generation.

MR. BADER reviewed a Callan presentation to show that 73 percent of small cap managers outperform the index, as does the ARM Board's small cap pool, so that is a good place to look for alpha. MR. BADER showed a hypothetical transaction to explain how futures work, and acknowledged that there are indications that swaps can be entered into with less expense. He emphasized that the point was that a portable alpha strategy could provide an additional source of excess performance, noting that Callan's presentation had just shown that nearly every asset class had a return of less than 8 percent.

MR. SHAW asked how long it would take this strategy to prove itself; MR. BADER replied that it would probably show affirmatively in three years. MR. BADER stated that this strategy would work if ARMB's investment managers continue to perform as they have in the past, if they can hold the cost line, and if the future of the swap in the Russell 2000 is not priced at too great a discount to allow them to benefit from the small cap managers.

CHAIR SCHUBERT recessed the meeting from 2:53 p.m. to 3:08 p.m.

### **13. GLOBAL EQUITY – BETA NEUTRAL**

JOHN HOLMGREN and ROGER IBBOTSON of Zebra Capital Management talked about a strategy they are proposing to the Board called Global Equity – Beta Neutral, which is based on some principles that MR. IBBOTSON presented at the Board’s Education Conference.

MR. IBBOTSON explained that the objective of an equity beta neutral long/short fund is to be beta neutral, or not sensitive to the market. This means that in up markets the full benefit is not realized, but in down markets losses are minimized. The objective is a 7 to 8 percent rate of return with a relatively low risk of 5 to 6 percent deviation per annum. The strategy would concentrate on mid and small cap stocks. The philosophy is generally the same as they use in the microcap fund, which is to buy companies with strong fundamentals which are not popular. MR. IBBOTSON gave examples to explain how the strategy works, and said that there are potentially very big returns with low risk. He showed a six-year track record of a fund that has been in existence since June 2010, and has had a positive return every year.

MR. IBBOTSON noted that they do have a higher volatility version of this with higher returns, and the intention for Alaska would be to mix the two funds together to control the volatility but get higher returns. The higher volatility fund had a shorter track record, but showed a net performance of 14.95 percent since inception.

MR. HOLMGREN reviewed the investment process, explaining how the research analytics try to determine the fundamental goodness of a company, and then combine that with measures of popularity which are driven by trading activity. He reviewed the global portfolio in four regions, showing last year’s gross returns, annualized gross returns, the standard deviation, and the return to risk. MR. HOLMGREN noted that the regions are not correlated with each other, thus providing a diversification effect. For risk management, Zebra uses a combination of proprietary systems as well as a third party, which MR. HOLMGREN described as very robust risk oversight. He emphasized that the fund was positive on profitability, value, and dividend yield, and tended to be very non-correlated not only with equity markets, which is to be expected, but also with other hedge funds, and with equity market neutral. MR. HOLMGREN said that this strategy makes money by buying what others don’t want to get bargains, and shorting what others get too excited about in order to generate great returns.

### **14. INVESTMENT ACTIONS/INFORMATION**

#### **1. Resolution 2016-01 High Yield Guidelines**

CIO GARY BADER recommended some amendments to the investment guidelines. The biggest change is that the draft guidelines change the process for identifying the rating of a security to match the benchmark, which MR. BADER said seems reasonable. The second change is the amount of holdings rated less than B3 could be loosened from 25 percent to the greater of 25 percent of the benchmark plus 5 percent, which would not violate the investment guidelines. Therefore, staff recommended that the Board adopt Resolution 2016-01, which adopts these guidelines.

MR. TRIVETTE moved to adopt Resolution 2016-01. MRS. HARBO seconded the motion.

A roll call vote was taken, and the motion passed unanimously.

## **2. Futures**

MR. BADER asked the ARM Board to authorize staff to make transactions in futures contracts, which the Board has been using, but there is potential for considerable savings in investment management fees by having staff handle these transactions.

MRS. HARBO moved to authorize staff to transact in futures contracts. MS. RYAN seconded the motion.

COMMISSIONER HOFFBECK suggested that some constraints might be in order, and MR. BADER responded that they could tighten the parameters at the next meeting, when he would come back to the Board with more circumscribed restrictions on staff.

MR. BRICE moved to table the motion until the next meeting. MRS. HARBO seconded the motion.

MR. BADER suggested an amendment to the motion instead of tabling it, so MR. BRICE withdrew his motion to postpone.

MRS. HARBO moved to amend the motion to restrict staff to no more than \$500 million notional value Russell 1000 futures, and \$500 million notional value Russell 2000 futures. MR. TRIVETTE seconded the amendment.

A roll call vote was taken, and the amended motion passed unanimously.

## **3. Swaps**

MR. BADER asked the ARM Board to authorize staff to engage in swaps transactions on the Russell 1000 and the Russell 2000, no more than \$500 million in each swap.

COMMISSIONER HOFFBECK moved to authorize staff to engage in swaps transactions with the \$500 million limit. MRS. HARBO seconded the motion.

A roll call vote was taken, and the motion passed unanimously.

## **4. Portable Alpha**

MR. BADER asked the ARM Board to authorize staff to engage in portable alpha strategies constrained by the same limitations put by the Board on swaps and futures.

MR. TRIVETTE moved to authorize staff to engage in portable alpha strategies as defined. COMMISSIONER HOFFBECK seconded the motion.

A roll call vote was taken, and the motion passed unanimously.

## **5. Cash Equitization**

MR. BADER asked the ARM Board to authorize staff to transition the management of the cash equitization program from State Street Global Advisors to internal staff, unless they were able to negotiate a satisfactory fee agreement with State Street.

MRS. HARBO moved to authorize staff to manage the cash equitization program internally, subject to negotiations with State Street Global Advisors. MR. TRIVETTE seconded the motion.

A roll call vote was taken, and the motion passed unanimously.

## **6. Sentinel Realty Capital Expenditure**

MR. BADER explained that an apartment building in Folsom, California that is one of the ARMB's investments needs some modifications. He asked the Board to authorize an expenditure of up to \$525,000 by Sentinel Realty Advisors to have the work done. MR. BADER stated that the contractor that built the building has gone bankrupt and cannot do the repairs or be pursued.

MR. TRIVETTE moved to authorize Sentinel Realty Advisors to spend \$525,000 on the necessary modifications. MRS. HARBO seconded the motion.

MR. PIHL questioned whether the realty advisor company bore any responsibility; MR. BADER replied that the investment managers do very thorough evaluations, and this was not something that would be caught in a normal evaluation of the building. The flaw only came to light after another building of similar design by the same contractor had a stairway collapse with a fatality. MR. BADER noted that Sentinel has been forthright with the Board, previously accepting responsibility for a problem that developed in a building that they had purchased on behalf of the ARMB, but this was an unforeseeable situation and he believes they did proper due diligence.

MS. ERCHINGER noted that a key point in the written report was that the stairway collapse in the other building was due to water infiltration, which is not a problem in the property that the ARMB owns. It is not a simple case of substandard construction, but it is prudent to take every precaution.

A roll call vote was taken, and the motion passed unanimously.

## **7. Beta Neutral-Advantage Mandate**

MR. BADER recommended that the ARMB invest in the Zebra Global Equity Beta Neutral and Advantage funds.

MR. TRIVETTE moved to direct staff to invest \$200 million in the Zebra Global Equity Beta Neutral and Advantage funds, subject to satisfactory negotiation of terms. MRS. HARBO seconded the motion.

MR. TRIVETTE asked whether MR. BADER expected to put \$100,000 in each fund; MR. BADER stated that they intend to confer with MR. HANNA to determine the proper mix between the two strategies.

COMMISSIONER FISHER asked what percentage of Zebra's assets under management this would represent; MR. BADER replied that he doesn't know the numbers, but Zebra has one other large multinational corporation invested which he believes is about to invest more.

A roll call vote was taken, and the motion passed unanimously.

## **8. Defined Contribution Plan Proposal**

MR. BADER reminded the Board that the Defined Contribution Committee had recommended that the Board engage the services of Callan Associates to do a review of the defined contribution plans.

MR. TRIVETTE moved to engage Callan for services as proposed in the memo from Callan Associates dated October 16, 2015, subject to successful fee negotiations. MR. BRICE seconded the motion.

A roll call vote was taken, and the motion passed unanimously.

## **UNFINISHED BUSINESS**

### **1. Disclosure Reports**

MS. HALL stated that the disclosure reports were included in the meeting packet, and there was nothing unusual to disclose.

### **2. Meeting Schedule**

MS. HALL noted two changes to the 2016 meeting calendar. The first is that a Defined Contribution Committee meeting will be added to the September meeting. Also, in June, the 23<sup>rd</sup> will be the committee meeting day and the 24<sup>th</sup> will be the Board meeting day.

### **3. Legal Report**

MR. GOERING reported that they are engaged in discovery in the Petrobras matter, and all of the disclosures and production have been completed. They still expect a settlement along the way, but if not, the trial is scheduled for September. MR. TRIVETTE asked if there had been any surprises; MR. GOERING replied no, but it appears that only he and Chris Poag, the general counsel for the Permanent Fund, will be deposed in the case, avoiding having any investment staff in the hot seat.

MR. GOERING stated that they are still looking into the Volkswagen matter, but that would take place in German courts, not the U.S. Also, they are still in the process of updating the MOU with the Department of Law to come up with domestic and foreign litigation policy for the Board.

#### **NEW BUSINESS**

None.

#### **OTHER MATTERS TO PROPERLY COME BEFORE THE BOARD**

None.

#### **PUBLIC/MEMBER COMMENTS**

None.

#### **INVESTMENT ADVISORY COUNCIL COMMENTS**

None.

#### **TRUSTEE COMMENTS**

MR. PIHL noted that everyone has the memo and summaries that he prepared; he remarked that he felt that with everything currently going on and the state position on state assistance funding, it was informative to show a longer-term picture of how the funds have worked in the system. MR. PIHL said the importance of this state assistance over time must be obvious to everyone, and he thinks that over the next few years there will be little or no state assistance, and it will lead to some painful years down the road.

MS. ERCHINGER thanked MR. TRIVETTE and MR. PIHL for their service on this Board, and commented that the Board will miss their counsel, their historical perspective, and their willingness to dive into details. MRS. HARBO added that they will be missed, she wishes them well, and she hopes that they might still attend some meetings.

MR. TRIVETTE commented that it has been an incredible 11 years, and the staff of the Department of Revenue, Department of Administration, and IAC have been top-notch and have provided tremendous value. He said it has been rewarding to spend time with people of such caliber, and it

has been an honor to work with everyone. MR. TRIVETTE added that he had not planned to leave at this time, but it seems prudent.

CHAIR SCHUBERT remarked that both MR. TRIVETTE and MR. PIHL have been tremendously helpful in delving deeply into issues that interested or concerned them and bringing their perspectives to the Board. She also commented that she hopes they might call in for meetings in the future.

MR. BADER commented that he appreciates the collegiality of this Board, and he thanked MR. TRIVETTE and MR. PIHL on behalf of the staff for being easy to work with and appreciative of the contributions of staff.

### **FUTURE AGENDA ITEMS**

None.

### **ADJOURNMENT**

There being no objection and no further business to come before the board, the meeting was adjourned at 4:12 p.m. on February 18, 2016, on a motion made by MR. TRIVETTE and seconded by MR. PIHL.



Chair of the Board of Trustees  
Alaska Retirement Management Board

### **ATTEST:**



Corporate Secretary

Note: An outside contractor recorded the meeting and prepared the summary minutes. For in-depth discussion and more presentation details, please refer to the recording of the meeting and presentation materials on file at the ARMB office.

Confidential Office Services  
Karen Pearce Brown  
Juneau, Alaska